TAYLOR BANK
Calvin B. Taylor Banking Company / P.O. Box 5, 24 N. Main, Berlin, Maryland 21811 / 410-641-1700 / Member F.D.I.C.

October 18, 2012

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Delivered via email comments@FDIC.gov

Ms. Jennifer L. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Delivered via email regs.comments@federalreserve.gov

Re: Basel III and Standardized Approach Proposed Rules

Ladies and Gentlemen:

We thank you for the opportunity to provide our comments on the joint notices of proposed rulemaking related to Basel III and the Standardized Approach as issued by the Board of Governors of the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "banking agencies") on June 7, 2012.

Calvin B. Taylor Banking Company of Berlin, Maryland (Taylor Bank) has proudly served our local community for over 120 years. During these years, Taylor Bank has grown alongside the local community and currently has 10 branches located throughout the coastal resort areas of Maryland & Delaware with total assets exceeding $430 million. Our loyal customer base includes many individuals, small businesses, and local governments which in turn drive the tourism based economy in our service area.

As evident by our high levels of capital, we believe that a strongly capitalized institution is in the best position to meet the demands of all stakeholders including customers, employees, shareholders, and the Federal Deposit Insurance Fund. While we support strong levels of capital, the proposed rules to implement Basel III and the Standardized Approach do not fairly and effectively accomplish the goal of strengthening capital, especially in the community bank sector. We acknowledge the difficult task of designing capital standards and creating regulations to address the events that led to the financial market crisis while simultaneously supporting economic recovery. However, the proposed "one-size fits all" approach of the proposed rules overly complicate regulatory capital requirements for community banks and generate unnecessary overhead expenses even when the institution has a simplistic operating model such as our bank. A simple regulatory capital model for community banks provides greater transparency and enables an institution to effectively plan and utilize capital.

The following comments address specific items within the proposed rules that would significantly impact Taylor Bank if adopted.

I. Inclusion of unrealized gains and losses on available-for-sale securities in Common Equity Tier 1 Capital

Similar to other institutions, Taylor Bank has experienced historically high deposit growth, tepid demand for new loans, and deleveraging by current borrowers throughout the recent economic recession. As a result, we also have a historically high level of investments consisting primarily of U.S. government debt securities with a substantial portion designated as available-for-sale for liquidity management purposes. Throughout the economic recession Taylor Bank held all debt securities until maturity or until a call option was exercised thus no unrealized gains or losses were realized in earnings or capital. Due to our substantial investment holdings a modest increase in interest rates could generate a significant unrealized loss, thereby reducing capital under the proposed rules. The likelihood however, that a loss would be realized is remote due to our strong liquidity position and short term investment maturities. The net result would be significant temporary fluctuations in capital that do not accurately reflect the strength of Taylor Bank, and potentially subject us to unnecessary regulatory or shareholder scrutiny. To alleviate the significant temporary fluctuations in capital, we would designate significantly fewer investments as available-for-sale resulting in reduced liquidity. However, the change in designation will occur over time as the investment portfolio matures leaving our capital volatile for a period of time.

It is also important to note that U.S. Generally Accepted Accounting Principles (GAAP) already addresses the recognition of other than temporary impairment (OTTI) of investments which is recognized in earnings and reduces capital. Adjusting capital with unrealized gains and losses is temporarily increasing or decreasing capital for events that will typically not occur. The banking agencies should consider modifying the proposed rules to exclude unrealized gains and losses from typical safe and sound investments such as U.S. government and municipal debt securities.

II. Increased Risk Weighting for Residential Mortgages

Taylor Bank's lending model has withstood the economic challenges of the 20th and 21st centuries including the most recent economic recession (aka The Great Recession). Residential mortgages are a key component of our loan portfolio and our knowledge of the local real estate market along with conservative underwriting standards has resulted in minimal losses from residential mortgages. Vast changes to the risk weighting process for residential mortgages cause us great concern.

First, our residential mortgages are written on demand with an alternate disclosed maturity, which provides Taylor Bank with an invaluable interest rate risk (IRR) management tool. This tool allows us to keep the loans in portfolio rather than sell them into the secondary market. The most significant benefit is our customers value the service that our bank provides in servicing their mortgage. Generally, mortgage customers utilize our bank for all of their banking needs which enables us to forge a strong relationship that is a valuable asset especially if a customer experiences challenging economic conditions. Based on the proposed rules, we conclude that our entire residential mortgage loan portfolio would be risk-weighted between 100% and 200% depending on the loan to value (LTV) at origination. This change within the proposed rules would at a minimum double the amount of capital required to hold our residential mortgage loans in portfolio and reduce our risk based capital ratios by at least 500 bps. Due to the impact on risk based capital we would consider selling a portion or all our of residential mortgage loan portfolio into the secondary market which would have a devastating effect on our customer service reputation and cause a reduction in loan staff. A sale of loans is also unchartered territory for Taylor Bank thus complicating our business model and subjecting ourselves to other provisions of the proposed rules related to residential mortgage loans sold into the secondary market.

Our ability to continue offering a residential mortgage loan product will also be significantly affected by the proposed rules. Furthermore, the use of a balloon mortgage product would not be a viable alternative under the proposed rules thus leaving us no significant tool to manage IRR. The exit of community banks from residential mortgage lending would have a serious adverse effect on the local real estate market at a time when that market is just beginning to recover.

Assuming that a portion of our existing residential mortgage loans remain in portfolio, the cost of compliance to properly risk weight the existing loan portfolio (based on loan-to-value ratios at origination and other underwriting criteria) will require a significant level of effort and may require the hiring of new staff. Costs including staffing, training, and core system modifications would significantly impact our earnings, in addition to the underlying opportunity cost that is created. We also believe that a significant change in the risk-weighting methodology of residential mortgage loans impacts the loan pricing model, yet we are unable to reprice the existing portfolio and cannot increase pricing on new residential mortgages due to the high priced mortgage laws. At a minimum, a grandfather clause for the existing portfolio would be appropriate to eliminate the burden caused by the risk weight re-measurement of the existing portfolio. Adjustments to the high priced mortgage laws should also be considered if risk-weightings are substantially modified.

III. Increased Risk Weighting for Unused Commitments

Working capital lines of credit are a key lending product for small businesses that operate in the seasonal tourism based economy of our service area. During the fall and winter months we experience increased levels of unused working capital lines of credit as our small business customer make agreed upon repayments during and immediately after the peak summer season. As spring arrives these customers make draws on their lines of credit in preparation for the upcoming season. If we are required to risk-weight unused working lines of credit as outlined in the proposed rules, we would experience risk based capital volatility of 50 bps or more. To reduce capital volatility, we would be required to alter our existing lines of credit so they mature after the peak summer season or impose fees for customers that maintain unused working capital line of credit during the offseason. This change will reduce the flexibility that our small business borrowers have and burden them with increased borrowing costs.

In conclusion, the significant impacts of the proposed rules relative to Taylor Bank have been noted above, which we believe is a compelling reason to significantly alter the proposed rules or exclude community banks all together. The banking industry would also greatly benefit from an analysis by the banking agencies as to why the proposed rules are relevant to the entire U.S. banking system and the evidence that making the proposed changes would prepare the industry for a similar financial crisis as the one most recently experienced. Our belief is that a regulatory capital model developed for systematically important financial institutions should not be applied to the community bank industry and will undoubtedly impact our ability to help drive economic recovery in our local market.

Sincerely,

CALVIN B. TAYLOR BANKING CO.

Raymond M. Thompson
President and CEO

M. Dean Lewis
Financial Officer

MDL/ses

Cc: U.S. Senator Barbara A. Mikulski
U.S. Senator Benjamin L. Cardin
U.S. Representative Andy Harris
Kathleen M. Murphy, Maryland Bankers Association
Mark Kaufmann, Maryland Commissioner of Financial Regulation